

A mortgage or other similar lien on real property acquired by a charitable organization in a liquidating distribution from a corporation is 'business lease indebtedness' within the meaning of section 514(c) of the Internal Revenue Code of 1954.

Advice has been requested whether mortgages on real property under the circumstances described below represent business lease indebtedness as defined in section 514(c) of the Internal Revenue Code of 1954.

A charitable organization, exempt from Federal income tax under section 501(c)(3) of the Code after June 30, 1950, acquired all the capital stock of a corporation. The assets of the corporation consisted of several parcels of real estate, each subject to a mortgage and a 99-year lease. The corporation was subsequently dissolved, and all of its assets, subject to the leases and indebtedness, were distributed in a liquidating distribution to the charitable organization.

A charitable organization exempt under section 501(c)(3) of the Code is subject to the unrelated business income tax imposed by section 511 of the Code on income received from business leases. See sections 512(b)(4), 514(a)(1), and 514(a)(2) of the Code. The term 'business lease' is defined in section 514(b) of the Code as a lease of real property for a term of more than 5 years if at the close of the lessor's taxable year there is a business lease indebtedness, as defined in section 514(c) of the Code with respect to such property.

Section 514(c) of the Code provides, in part:

(2) Property Acquired Subject to Mortgage, etc. Where property is acquired subject to a mortgage or other similar lien, the amount of the indebtedness secured by such mortgage or lien shall be considered (whether the acquisition was by gift, devise, or purchase) as an indebtedness of the lessor incurred in acquiring such property even though the lessor did not agree to pay such indebtedness, except that where real property was acquired by gift, bequest, or devise before July 1, 1950, subject to a mortgage or other similar lien, the amount of such mortgage or other similar lien shall not be considered as indebtedness of the lessor incurred in acquiring such property. (Emphasis added.)

The specific question presented is whether property received by an exempt organization in a corporate liquidating distribution is 'acquired' within the meaning of section 514(c) of the Code.

The term 'acquired' as used in section 514(c)(2) of the Code applies to all acquisitions of real property subject to a mortgage or similar lien, regardless of the method of

acquisition. The parenthetical clause, 'whether the acquisition was by gift, devise, or purchase,' is illustrative only and is not intended to limit the term 'acquired.' Furthermore, the term 'purchase,' as it is used in section 514(c) of the Code, is broad enough to include the receipt of property by a shareholder in a corporate liquidating distribution.

For these reasons property received in a corporate liquidating distribution is 'acquired' within the meaning of section 514(c) of the Code. Accordingly, based on the facts in this case, the mortgages on the property acquired by the organization represent business lease indebtedness.